

**FOLLOW-UP AUDIT OF THE  
BUREAU OF ALCOHOL, TOBACCO AND FIREARMS'  
SPECIAL OCCUPATIONAL TAX PROGRAM**

OIG-01-052

March 2, 2001



**Office of Inspector General**

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**United States Department of the Treasury**

March 2, 2001

MEMORANDUM FOR BRADLEY A. BUCKLES, DIRECTOR  
BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

FROM: Dennis S. Schindel /s/  
Assistant Inspector General for Audit

SUBJECT: Follow-up Audit of the Bureau of  
Alcohol, Tobacco and Firearms' Special  
Occupational Tax Program

This memorandum transmits the final report on our audit of the Bureau of Alcohol, Tobacco and Firearms' (ATF) Special Occupational Tax Program (SOT). The report addresses ATF's efforts to administer the SOT for alcohol beverage retailers. The objective of our audit was to assess the corrective measures ATF implemented in response to our December 1996 audit report titled *Audit of Alcohol, Tobacco, and Firearms Special Occupational Tax Program* (OIG-97-016). We conducted the follow-up audit at ATF's Headquarters in Washington, D.C., and at the National Revenue Center (NRC) in Cincinnati, Ohio.

We found ATF took insufficient corrective actions in response to our previous audit report. ATF claimed it took actions to increase its retailer compliance rate from 83 percent to 89 percent; however, various program officials were unable to tell us what specific actions, if any, ATF had implemented. In addition, ATF's calculated compliance rate represents only the percentage of those retailers that are known to ATF by previously filing and paying SOT. Thus, the rate may not truly reflect the actual retailer compliance rate since the database may not be complete.

In addition, ATF did not contact any states about adding information such as Employer Identification Numbers to their databases to facilitate ATF's state matching program. Further, while ATF initiated a project in 1998 to determine the feasibility of automating the matching of state retail data with the SOT master file, ATF never followed through with this project's recommendations to determine whether automating the state matching program would be effective.

Finally, we found that, beginning in July 1998, ATF ceased one of its methods of ensuring SOT compliance -- performing matching of ATF and state information on retailers. This matching had been a cost-effective method of identifying and

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collecting additional SOT revenue, and generated about \$2.9 million from March 1995 to June 1998.

During our follow-up audit, we sampled 275 businesses in 11 states and found that 132, or 48 percent, were licensed by the states but were not listed in ATF's SOT master file. Accordingly, based on ATF's results from 1995 to 1998 and our testing of these businesses, we believe ATF may still be losing significant SOT dollars each year from state-licensed alcohol retailers who are not in ATF's SOT master file and subsequently are failing to pay the SOT. Because ATF's matching program consistently generated about \$800,000 per year in SOT revenue over several years, we believe this matching program, if restarted, could continue to achieve similar results.

In response to the draft report, you concurred with the findings and recommendations. According to your response, in May 2000, ATF assigned two data entry contract employees to devote all of their time to matching new SOT payers against the SOT database, as well as contacting the states to obtain new lists for matching. These employees will match the SOT database with the state listings. In addition, subsequent to developing electronic filing capabilities for industry members, ATF plans to work with the states to develop compatible systems that will enhance its SOT collection process. We believe the actions ATF has taken, and those it plans to take in the future, are responsive to our recommendations. Finally, your agreement to implement the recommendations from this current review should address the intent of the recommendations in our previous audit report. Therefore, no further action is required with respect to the prior recommendations.

Please be advised that we are recording potential revenue enhancements totaling \$2.4 million in the Inventory, Tracking and Closure system (ITC) for recommendation number 1. This recommendation is identified in Appendix 2 of our draft report. ATF will be responsible for recording the amount of revenue actually collected for this recommendation in the ITC.

We appreciate the courtesies and cooperation provided to our staff during the audit. Should you have any questions or require further assistance, please call me at (202) 927-5400, or a member of your staff may contact Donald Benson, Regional Inspector General for Audit, at (617) 223-8640.

Attachment

cc: Richard Hankinson  
Assistant Director, Office of Inspection

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# EXECUTIVE DIGEST

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## Overview

In July 1987, the Bureau of Alcohol, Tobacco and Firearms (ATF) assumed responsibility for administering the alcohol Special Occupational Tax (SOT) program from the Internal Revenue Service. Anyone who sells beverage alcohol as a part of a business is required to pay SOT. SOTs provide a source of revenue to offset the costs of regulating the alcohol industry and also aid ATF in its efforts to enforce the laws and regulations governing the alcohol industry.

Alcohol SOTs have been the subject of reports by both us and the U.S. General Accounting Office (GAO). In a report issued in June 1986, GAO estimated the retail alcohol SOT compliance rate was about 60 percent.<sup>1</sup> At that time, ATF concurred the 40 percent noncompliance found in GAO's sample was probably representative of noncompliance rates nationwide.

In December 1996, the OIG estimated the average compliance rate from 1993 to 1995 to be about 83 percent. However, as stated in another GAO report issued in August 1998, ATF estimated the compliance rate had risen to 89 percent for alcohol retailers as of April 3, 1998.<sup>2</sup>

We performed this follow-up audit of ATF's SOT program in accordance with our *Office of Audit Annual Plan for Fiscal Year 2000*.

## Objectives, Scope and Methodology

The objective of our audit was to assess the corrective measures ATF took in response to recommendations contained in our

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<sup>1</sup> *Tax Administration: Compliance and Other Issues Associated with Occupational Excise Taxes* (GAO/GGD-86-49).

<sup>2</sup> *Alcohol Special Occupational Taxes: Administration and Compliance Issues* (GAO/GGD-98-156). While GAO cited this ATF estimate in its report, it stated that the OIG and ATF had used different data and methods to compute the estimates and the data and methods left the accuracy of both estimates uncertain. GAO also stated that the audit work needed to quantify the potential error in these estimates was beyond the scope of its study.

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## EXECUTIVE DIGEST

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December 27, 1996, report titled *Audit of Alcohol, Tobacco and Firearms Special Occupational Tax Program* (OIG-97-016). We interviewed ATF program officials to determine what actions ATF had taken to increase alcohol retail compliance rates subsequent to this report. We also sampled retailers on recent state alcohol retail lists to determine whether the alcohol businesses licensed by the states were included in ATF's SOT master file.

### **Audit Results**

We could not determine what actions, if any, ATF took subsequent to our previous report that caused the retail alcohol SOT compliance rate to increase. Although ATF's calculations show that the compliance rate was higher, these calculations only take into account those retailers known to ATF. These rates can be misleading because ATF does not know the exact number of alcohol beverage retailers that are in business. Additionally, ATF did not contact any states to see whether they would be willing to modify their databases to aid in ATF's attempts to match its SOT master file with state retailer information. Finally, because ATF reassigned the staff to other priority work, it ceased performing one of its methods of enforcing SOT compliance – matching state retail records with its master file. In the past, this was a cost-effective means of identifying potential new SOT taxpayers.

We performed limited matching of state licensed alcohol retailers to ATF's SOT master file and found about 48 percent of the businesses licensed by the states were not in ATF's SOT master file.

Accordingly, we believe ATF could continue to collect significant SOT dollars annually through matching. Because this matching program consistently generated about \$800,000 per year in SOT revenue over several years, we estimate ATF could collect about \$2.4 million over the next 3 years by restarting this program.

### **Recommendations**

We recommended that ATF reinstate the state matching program at the National Revenue Center (NRC) and, to further improve the program, take steps where practical to automate the matching.

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## EXECUTIVE DIGEST

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### Management Response and OIG Comment

ATF management agreed with the findings and recommendations. As of May 2000, ATF assigned two data entry contract employees to match new SOT payers against the SOT database as well as contact the states to obtain new lists for matching. As the new lists are received at the NRC, these employees will match the SOT database with the state listings. In addition, subsequent to developing electronic filing capabilities for industry members, ATF plans to work with the states to develop compatible systems that will enhance its SOT collection process. We believe the actions ATF has taken, and those it plans to take in the future, are responsive to the recommendations from this review as well as the intent of the recommendations from our prior review and will increase SOT collection among retailers. The complete text of ATF's response is provided in Appendix 3.

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# BACKGROUND

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Any person who engages in the business of selling beverage alcohol is required to pay an annual SOT. ATF assumed the responsibility for administering the alcohol SOT program from the Internal Revenue Service in July 1987. ATF collected about \$105 million in SOT during Fiscal Year 1999. ATF estimated 90 percent of that amount came from alcohol SOTs.

There are separate occupational taxes for alcohol producers, wholesalers, and retailers. The tax is a fixed amount per business location per year. The tax is \$1,000 for large producers--those who grossed more than \$500,000 the previous year, and \$500 for small producers--those who grossed less than \$500,000 the previous year. Wholesalers pay a \$500 occupational tax for each location. Retailers, who make up the largest group of SOT taxpayers, are required to pay \$250 per year.

Retailers include a wide variety of businesses such as liquor stores, bars, restaurants, sports facilities, grocery stores, convenience stores, airlines, caterers, and hotels. Federal law does not require retailers to obtain Federal permits from ATF to operate (unlike producers and wholesalers who must obtain permits from ATF). Retailers are, however, licensed by the states and some local jurisdictions.

ATF maintains a SOT master file – a Federal database of businesses that have paid SOTs in previous years or are otherwise known to ATF. Each year, ATF sends these known alcohol businesses registration and stamp renewal returns. ATF also uses several other methods to enforce SOT compliance, such as (1) publicizing occupational tax information, (2) licensing producers and wholesalers, (3) assessing civil and criminal penalties and interest, and (4) verifying SOT compliance during on-site inspections.

As discussed in our December 1996 report, the Department of the Treasury (Department) loses millions of dollars annually in SOT revenue as a result of retail alcoholic beverage dealers who do not pay the SOT tax. At that time, we estimated alcoholic beverage retailers did not pay over \$64 million of SOT during tax years 1993 to 1995.

ATF management disagreed with a recommendation in our previous report that verification of SOT payment be devolved to the states because it said this recommendation would be difficult to implement,

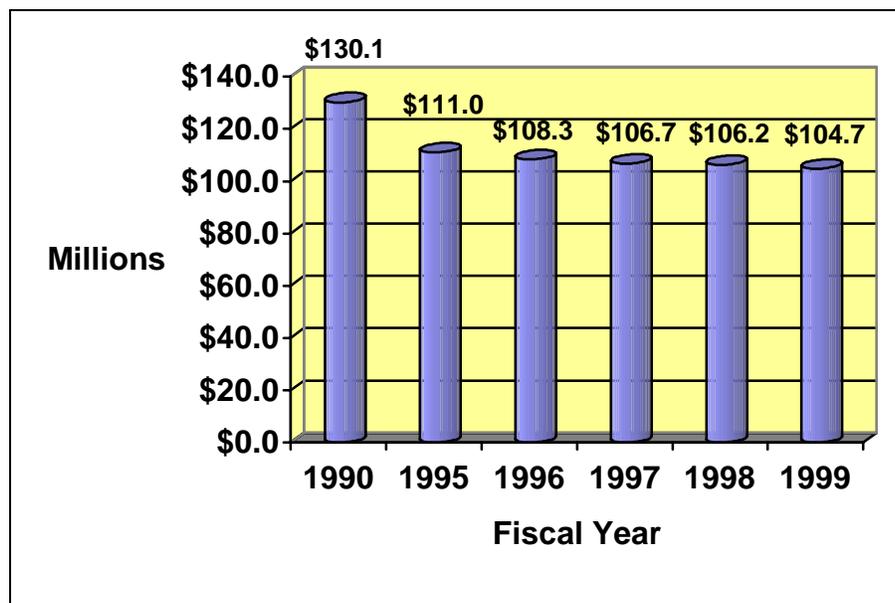
## BACKGROUND

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and would require legislation at the Federal, state, and local levels. Since our December 1996 report, ATF claims it has taken other actions which has enabled ATF to increase the SOT compliance rate from 83 to 89 percent.

While ATF calculated that the retail compliance rate has increased over the last few years, the amount of SOT dollars collected by ATF has steadily declined, as shown in the following chart.

**Chart 1: SOT Revenues Fiscal Years 1990 and 1995 to 1999**



SOT revenues have been decreasing over the years because ATF has been collecting less delinquent SOT tax (tax owed for the prior year) and penalties and interest (P&I).<sup>3</sup> ATF administered this program since 1987, and has apparently caught up with many of the delinquent or non-compliant retailers.

For example, \$0.9 million (less than 1 percent) of the total \$104.7 million SOT ATF collected in 1999 was related to P&I. In contrast, \$1.6 million (1.4 percent) of the total SOT collected in 1995

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<sup>3</sup> Failure to File and Failure to Pay Penalties

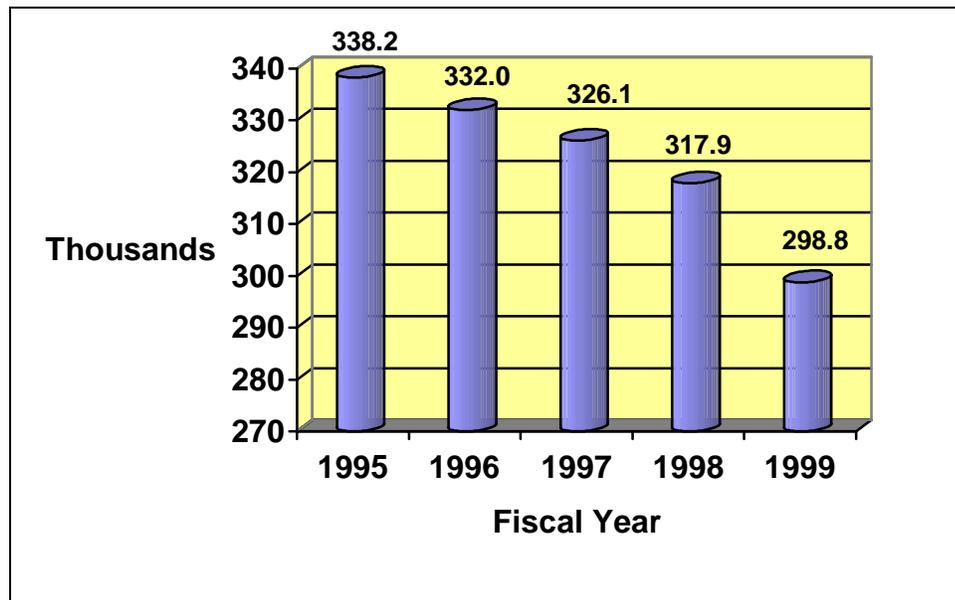
## BACKGROUND

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was related to P&I. Of the total \$130.1 million SOT that ATF collected in 1990, \$8.9 million (6.8 percent) was related to P&I, and \$8.7 million (6.7 percent) was related to delinquent tax.

Another reason SOT revenues are declining is because the number of entities who paid SOT has also decreased over the past few years, as shown in the following chart.

**Chart 2: Number of Alcohol Retailers Entities Who Paid SOT Fiscal Years 1995 to 1999**



According to several ATF officials, the declining number of entities who are paying SOT may be occurring for several reasons. First, there is high turnover in the retail alcohol business, with estimates as high as 20 percent turnover per year. Second, in 1988 the alcohol SOT rate for retailers was raised to \$250 by the Omnibus Budget Reconciliation Act of 1987. The SOT rate had been \$24 for retailers selling only beer, and \$54 for retailers selling wine or liquor. The increase in the SOT apparently put a lot of “mom and pop” businesses that sold relatively little alcohol out of the alcohol business.

## OBJECTIVES, SCOPE AND METHODOLOGY

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The audit objective was to assess the corrective measures ATF took in response to recommendations contained in our December 1996 audit report on the SOT program. Specifically, we evaluated:

- actions ATF took to increase its retailer compliance rate from 83 percent (as reported in the December 1996 audit report) to 89 percent,
- whether ATF had worked with state governments to add information such as Employee Identification Numbers (EIN) to their retailer databases so as to facilitate matching programs with ATF's SOT master file and the state databases, and
- actions ATF took in states with historically low rates of retailer compliance.

To accomplish our objective, we interviewed personnel in the Revenue and Inspection Divisions at ATF Headquarters, and the NRC in Cincinnati, Ohio. We also worked with NRC personnel to perform matching of state alcohol retailer lists with ATF's SOT master file.

We performed our audit between September 1999 and March 2000 in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and included such audit tests as we determined necessary.

# AUDIT RESULTS

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## **Finding 1. ATF Took Insufficient Corrective Actions to Improve SOT Compliance**

ATF took insufficient corrective actions in response to all three of the recommendations we made in the December 1996 audit report. Although ATF did not concur with our recommendation to devolve SOT payment verification to the states, it claimed to have taken other actions that increased the alcohol retailer compliance rate to 89 percent for 1998. However, we could not determine what these other actions were. Also, the 89 percent compliance rate was calculated based on only those retailers known to ATF. Additionally, ATF did not contact any states regarding adding information to their retailer databases to facilitate matching programs with ATF, nor did it complete an alternate corrective action to this recommendation. Finally, ATF reassigned the resources that were devoted to targeting states with historically low rates of SOT retailer compliance to perform other priority work in July 1998. This targeting program had, through matching of state and ATF data, resulted in collections of \$2.9 million in additional SOT from March 1995 through June 1998.

ATF believes it is not cost-effective to devote any additional resources to enforce SOT compliance. We performed limited matching of state alcohol retail records with ATF's SOT master file. Specifically, we randomly selected 275 retailers licensed by the states and found 132, or 48 percent, were not listed in ATF's SOT master file. ATF subsequently sent each of these businesses a new business package. As of May 18, 2000, 29 of these retailers paid approximately \$5,000 to ATF for SOT. Accordingly, we believe ATF is still losing significant SOT dollars each year. Because ATF consistently collected about \$800,000 per year from matching state and ATF records from 1995 to 1998, we estimate that ATF could collect about \$2.4 million in additional SOT over the next 3 years by reinstating the matching program.

# AUDIT RESULTS

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## Recommendations:

The ATF Director should:

1. reinstate the state matching program at the National Revenue Center;
2. take steps where practical to automate the state matching program.

## Management Response and OIG Comment

### Recommendation 1

ATF management agreed with the recommendation. As of May 2000, ATF assigned two data entry contract employees to match new SOT payers against the SOT database as well as to contact the states to obtain new lists for matching. As the new lists are received at the NRC, these employees will devote their time to matching the SOT database with the state listings. In addition, ATF plans to hire at least one summer employee to work full-time on this program.

The OIG believes the corrective actions taken or planned address the intent of the recommendation.

### Recommendation 2

ATF management agreed with the recommendation. ATF said it is taking steps to automate the state-matching program by conversion of the SOT database to an Oracle platform, developing electronic filing capabilities, and initiating plans to engage in discussions with states to develop compatible systems. In FY 2000, ATF converted all of its major databases, including the SOT database, to an Oracle platform in preparation for year 2000. Subsequent to developing electronic filing capabilities for industry members, ATF plans to work with the states to develop compatible systems that will enhance its SOT collection process.

The OIG believes the corrective actions taken or planned address the intent of the recommendation.

# AUDIT RESULTS

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## Details

### **Prior Recommendation 1: Verification of SOT Payment Should be Devolved to State or Local Licensing Activities**

#### ATF Response and Proposed Corrective Action

ATF did not concur with this recommendation. ATF believed this proposal would be very difficult to implement and would require legislation at the Federal, state, and local levels. Furthermore, ATF was not persuaded that handing over a specified percentage of the total revenue collections to the states would have a neutral or positive effect on revenue collections. ATF believed the projected net gains to the revenue were speculative and would not justify such a major legislative amendment. In accordance with Treasury Directive 40-01, ATF sent a memorandum to the Deputy Secretary of the Treasury Department on March 26, 1997, further explaining ATF's reasons for non-concurrence with the recommendation.

This recommendation remained unresolved for a significant period of time in the Department's Inventory, Tracking and Closure (ITC) system. In a memorandum dated March 31, 1999, we advised the Department that ATF could close out the recommendation based on an assertion by ATF that it had taken other actions as a result of the audit that improved SOT compliance rates to 89 percent.

#### OIG Follow-up Evaluation of Corrective Action

ATF did not implement any new measures subsequent to our December 1996 report. Additionally, ATF's compliance rate represents only the percentage of known retailers who paid the SOT. Accordingly, we conclude ATF has taken insufficient corrective action to our prior recommendation in this area.

During this follow-up audit, we attempted to determine what specific measures ATF had taken subsequent to our previous audit to increase the compliance rate to 89 percent. Based on discussions with the Chief and the Assistant Chief, NRC, we found ATF had not instituted any new enforcement methods since our December 1996 report. ATF's Assistant Director, Alcohol and Tobacco, told us that he was reluctant to invest additional resources to SOT enforcement.

## AUDIT RESULTS

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Although ATF had not implemented any new enforcement measures, we evaluated the “improved” compliance rate. As discussed in the December 1996 audit report, we estimated that the compliance rate for Fiscal Years 1993 to 1995 was 83 percent. ATF estimated that as of April 3, 1998, the retailer compliance rate was 89 percent. However, ATF’s definition of compliance was based on the percentage of retailers known to ATF who filed timely returns and paid the taxes due for Tax Year 1998.

Based on the above, we conclude ATF has taken insufficient corrective action to our prior recommendation in this area. The intent of the prior recommendation, however, was to increase the compliance rate with SOT. If ATF fully implements the recommendations in this current review, the intent of this prior recommendation will be met. Accordingly, no further action is required on the part of ATF with respect to the prior recommendation.

### **Prior Recommendation 2: ATF Should Negotiate with Those States Unable to Verify SOT Payment Prior to Issuing Licenses to Identify Alternative Methods of Increasing Compliance**

#### ATF Response and Proposed Corrective Action

ATF agreed that it would be very helpful if more states maintained information such as EINs in their databases to facilitate matching programs. ATF further said it had already worked with most states on the matching programs; however, ATF would make this issue a priority in its ongoing dialogue with the states regarding the state matching program.

#### OIG Follow-up Evaluation of Corrective Action

We conclude ATF has taken insufficient corrective action in response to this recommendation. First, a discussion with the Assistant Chief, NRC, indicated ATF did not contact any states about adding EINs or any other information to their databases to help facilitate the matching process. Second, although ATF initiated another related corrective measure, the action was not completed.

## AUDIT RESULTS

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In January 1998, ATF hired a contractor to determine whether state retail license records could be used, in a systematic method, to increase ATF's ability to collect SOT. According to the contractor's June 1998 report, the goals of the project were to:

- analyze state and SOT data to determine whether there was a valid basis for matching operations;
- develop a matching methodology which lends itself to automation; and
- recommend an approach to increasing compliance in a report which could be used as a foundation for increasing compliance in the state matching program.

The contractor analyzed state retail alcohol license data from California and Virginia and reported it had developed a logical, repeatable process that validated the concept of implementing a methodology for state matching. Further, the state matching analysis produced lists of licensees who represented potential additional revenue. In fact, the contractor reported the unmatched data file derived from the California data by applying the matching algorithms identified records with at least a 90 percent chance of containing valid new sources of SOT revenue.

The contractor recommended contacting the list of 23,547 new California licensees developed during the project and analyzing the responses to validate the reliability of the matching algorithms and estimate the response rate.<sup>4</sup> According to an ATF official in the Headquarters Revenue Division, the lists of unmatched names were sent to the NRC. However, an official at the NRC informed us that it did not take any action regarding these lists. At the time the NRC received these lists, ATF's Tax Processing Center was moving from one location in Cincinnati to the Federal building where the NRC is now located. About a year later, when NRC personnel had some time to look at this information, they deemed it to be not current or useful. By not following through timely on the contractor's analyses and recommendations, the \$296,000 of costs incurred by ATF for the contractor's work was, in effect, wasted.

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<sup>4</sup> The contractor also developed a list of 15,678 businesses for the State of Virginia, but did not mention Virginia in its recommendations.

## AUDIT RESULTS

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ATF closed-out this recommendation in the ITC and recorded March 31, 1999, as the completion date. ATF apparently erroneously used our March 31, 1999, memorandum to the Department as its basis to close both Recommendation 1 and Recommendation 2 in the ITC.

ATF's commitment to implement the recommendations from this current review will sufficiently address the intent of this prior recommendation. Specifically, ATF's plans to work with the states to automate the state matching program would necessarily involve the development of common identifiers, such as EINs. Accordingly, no further action is required of ATF on the prior recommendation.

### **Prior Recommendation 3: ATF Should Identify States with Historically Low SOT Compliance and Concentrate Efforts on the Licensees in those States to Enhance Compliance**

#### ATF Response and Proposed Corrective Action

ATF agreed with this recommendation and said it would dedicate resources to implement increased efforts in targeting states with low compliance rates. ATF stated information acquired by the audit team in its survey of the states would be helpful in this effort since it had provided ATF with a more solid data base reflecting the number of retailers licensed in each state.

#### OIG Follow-up Evaluation of Corrective Action

We conclude ATF has taken insufficient corrective action in response to this recommendation. ATF obtained the OIG's working papers, identified the 10 states with the lowest compliance rates, and said it would concentrate on these states when conducting its state matching program. However, ATF stopped performing its state matching program in July 1998, and reassigned its resources to other priority work. ATF did not take any other corrective action in regard to the recommendation.

One of the methods ATF used to ensure retailers complied with SOT regulations was to perform matching of ATF's SOT master file with state information on retailers (state matching program). ATF's state matching program was a cost-effective method of identifying and

## AUDIT RESULTS

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collecting additional SOT revenue. ATF conducted the state matching program at the NRC.

According to personnel at the NRC, the former Chief, Revenue Division, ATF Headquarters, made the decision to discontinue this work. The NRC contract personnel who were performing the state matching were reassigned to perform other higher priority work, such as updating industry statistics.

In the past, ATF received lists of alcohol retailers from all but five states. Contract personnel at the NRC manually compared the names and addresses of the businesses reported by the states as licensed alcohol retailers with the names and addresses of retailers listed in the SOT master file. According to NRC contract personnel, the data entry clerks would query the ATF SOT master file with the business name or the business address listed on the states' lists of alcohol retailers. For those businesses on the states' lists that were not in ATF's database, the NRC would mail a new business package to those retailers. ATF included a return envelope with a code in this package that enabled ATF to track how much revenue each clerk's matching efforts were generating.

From March 1995 to June 1998, the state matching program generated about \$2.9 million in SOT revenue, or approximately \$800,000 per year over this period. We estimated it cost ATF about \$128,000, or about \$.04 per dollar, to collect this money. The following table shows the results of ATF's state matching program.

**Table 1: State Matching Program Results Fiscal Years 1995 to 1998**

<b>Fiscal Year</b>	<b>Number Hours Matching Performed</b>	<b>Contract Hourly Rate</b>	<b>Estimated Matching Costs</b>	<b>Number of Businesses not in ATF SOT Master file</b>	<b>Number SOT Payments Received</b>	<b>Percentage Paid</b>	<b>SOT Dollars Collected by State Matching</b>
<b>1995</b>	1,340.75	\$15.73	\$21,090	7,528	3,664	49%	\$ 883,196
<b>1996</b>	2,764.50	\$15.73	\$43,486	8,723	3,493	40%	\$ 874,567
<b>1997</b>	2,944.50	\$16.52	\$48,643	10,500	3,130	30%	\$ 777,553
<b>1998</b>	837.50	\$17.35	\$14,531	4,754	1,616	34%	\$ 405,975
<b>Total</b>	7,887.25		\$127,750	31,505	11,903	38%	\$2,941,291

## AUDIT RESULTS

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Although the costs to conduct the state matching program were higher than costs to administer the alcohol and tobacco excise taxes (usually less than \$.01 per dollar), the matching program also provided ATF with the names and addresses of alcohol retailers to add to its database. Thus, the state matching program was beneficial because it was a means to identify alcohol retail businesses that were not previously known to ATF. Once added to its SOT master file, ATF would annually mail renewal forms to these newly identified businesses, generating further SOT revenue.

At the time of our audit field work, ATF was still receiving some state retailer information at the NRC. We worked with NRC personnel to do some limited testing to determine whether the state matching program would still be a cost-effective way to identify retailers who owed SOT.

During the week of February 28, 2000, we took a random sample of alcohol retailers from states still sending retailer information to ATF. Specifically, we randomly selected 275 state-licensed alcohol retailers by selecting 25 businesses each from 11 states. We queried ATF's SOT master file to determine how many of these retailers were in ATF's database. Our query indicated 132 of the 275 retailers, or 48 percent, were not in ATF's SOT database. This indicated these businesses may owe SOT.

ATF subsequently sent packages to the 132 businesses advising them of the SOT requirement. As of May 2000, 34 businesses responded to ATF of which 29, or 85 percent, sent in SOT payments totaling \$4,834. For the other 98 businesses, either the businesses did not respond (90 businesses) or ATF's package was returned as undeliverable (8 businesses).

While we recognize the administrative costs of the SOTs are high relative to the costs of administering alcohol excise taxes, the state matching program serves an important purpose. First, it generates additional SOT revenue to the Federal Government. Second, it puts alcohol retail businesses on notice that they owe SOT, adds the names of these businesses to ATF's master file for future billings, and advises the businesses of the fines and penalties associated with failing to file or pay this tax. We conservatively estimate that ATF could enhance revenues by about \$800,000 per year, or \$2.4 million

## AUDIT RESULTS

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over the next 3 years, if it reinstated the state-matching program. If ATF fully implements the recommendations in this current review, the intent of this prior recommendation will be met. Accordingly, no further action is required on the part of ATF with respect to the prior recommendation.

## **ABBREVIATIONS**

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ATF	Bureau of Alcohol, Tobacco and Firearms
EIN	Employer Identification Number
GAO	U.S. General Accounting Office
ITC	Inventory, Tracking and Closure system
NRC	National Revenue Center
P&I	Principal and Interest
SOT	Special Occupational Tax

## **SCHEDULE OF POTENTIAL REVENUE ENHANCEMENTS FROM IMPLEMENTATION OF AUDIT RECOMMENDATIONS**

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A revenue enhancement is an action recommended in an OIG audit report which would, if implemented, enhance the General Fund receipts of the Federal Government, usually without having any budgetary impact on any of the Department of the Treasury's appropriations. The following potential revenue enhancements will be recorded in the Inventory, Tracking and Closure system (ITC) upon issuance of our final report.

Recommendation Number	Potential Revenue Enhancement Amount
Finding 1 – Recommendation 1	\$2,400,000

The recommendation relates to reinstating a state matching program of alcohol beverage retailers to determine if they had paid the Special Occupational Tax (SOT). It is ATF management's responsibility to record the actual revenue enhancements realized in the ITC for the collection of SOT assessments made as a result of the implementation of this recommendation.

# MANAGEMENT RESPONSE



DIRECTOR

DEPARTMENT OF THE TREASURY  
BUREAU OF ALCOHOL, TOBACCO AND FIREARMS  
WASHINGTON, DC 20226

JAN 24 2001

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MEMORANDUM TO: Assistant Inspector General for Audit

FROM: Director

SUBJECT: Management Response to Office of Inspector  
General's (OIG) Draft Report APH-99-081:  
Follow-up Audit of ATF's Special  
Occupational Tax Program

This responds to the OIG's December 7, 2000, draft report of findings from a recent follow-up audit of the Bureau of Alcohol, Tobacco and Firearms' (ATF) efforts to administer the Special Occupational Tax (SOT) program for alcohol beverage retailers. We take seriously all our revenue collection responsibilities, and welcome the opportunity to respond to your findings and recommendations.

The objective of this audit was to assess the corrective measures ATF implemented subsequent to an audit report issued to ATF in December 1996 titled *Audit of Alcohol, Tobacco, and Firearms Special Occupational Tax Program* (OIG-97-016). You requested that we indicate our concurrence or non-concurrence with each finding and recommendation of the follow-up audit, and the estimated revenue enhancement amount.

**Finding 1. ATF Took Insufficient Corrective Actions to Improve SOT Compliance**

The Draft Audit Report listed two specific recommendations to address this finding. We will address the actions we have taken regarding these recommendations.

## MANAGEMENT RESPONSE

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Assistant Inspector General for Audit

**Recommendation 1: The ATF Director should reinstate the state-matching program at the National Revenue Center.**

We concur with this recommendation, and as of May 2000, have assigned two data entry contract employees to devote all of their time to matching new SOT payers against the SOT database, as well as contacting the states to obtain new lists for matching. As the new lists are received at the National Revenue Center (NRC), these employees will devote their time to matching the SOT database information with the state listings.

After the December 1996 audit, ATF began contacting each state for listings of alcohol beverage retailers and wholesalers/distributors in an effort to match the state lists with the SOT database and to determine those states with the largest noncompliance. We received listings from all states and began a manual process of matching these lists with the SOT database.

To prioritize this work, we took advantage of the IG's audit workpapers to identify those states with the highest noncompliance. The equivalent of two full time staff years was devoted to state matching. It was during this period that collections resulting from state matching averaged \$800,000 per year. This effort continued from early 1997 until July 1998 when the (then) Chief, Revenue Division redirected resources for state matching to imaging and updating industry statistics. The staffing resources at the NRC have also been redirected over the last year to work on collection of the tobacco floor stocks tax, implementing new legislation on issuing permits to tobacco importers, and developing systems for verifying alcohol and tobacco export documentation.

The current state-matching program is still a labor-intensive process. As stated above, since the lists that were used from early 1997 to July 1998 are outdated, the two data entry contract employees are

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requesting updated lists from the states. In addition to using these two employees on state matching, we plan to hire at least one summer employee to work full-time on this program.

**Recommendation 2. To further improve the matching, the ATF Director should take steps where practical to automate the state-matching program.**

We concur with this recommendation, and are taking steps to automate the state-matching program by conversion of the SOT database to an Oracle platform, developing electronic filing capabilities, and initiating plans to engage in discussions with states to develop compatible systems.

The current draft report notes that ATF hired a contractor to determine whether state retail license records could be used, in a systematic method, to increase ATF's ability to collect SOT. However, the merger of the previous Tax Processing Center and the Technical Services offices into the NRC shifted priorities that affected the testing. After the initial merger occurred the information to be tested was outdated and no longer useful.

In FY-00, ATF converted all its major databases (including the SOT database) to Oracle platform in preparation for Y2K.

During our gathering of information from the various states on coordinating our systems with theirs to enhance the SOT collections, we discovered incompatibilities that would require extensive revisions both to our systems and those maintained by the states.

Recognizing that automation could enhance this process, ATF estimates that \$50,000 in funding would be needed for a feasibility study to evaluate whether or not the state matching process could be automated using the existing database. This amount only

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reflects the cost of the feasibility study and not the actual cost of automating this process. The amount estimated for the study will be evaluated against other bureau funding priorities for our databases.

ATF is currently working with Treasury's Financial Management Service (FMS) to pilot an electronic filing capability that will be offered to all Federal government agencies. In preparation for electronic filing, we have conducted an integration study for the tax and business systems at the NRC. Although we will initially offer electronic filing to industry members for excise tax and operational reporting purposes, we plan to offer electronic filing and payment for SOT payers by FY-03. Subsequent to developing electronic filing capabilities for industry members, we plan to work with the states to develop compatible systems that will enhance our SOT collection process.

### **Estimated Revenue Enhancement Amount**

The draft report notes that the previous audit findings disclosed ATF's matching program consistently generated about \$800,000 per year in SOT revenue. Consequently, the auditors' estimate is that this program will result in ATF collecting about \$2.4 million in additional SOT over the next 3 years. This estimate is based on statistics compiled by the NRC on the state-matching program as it was conducted between 1995 and July of 1998. Therefore, we concur that this estimate of additional taxes that could be collected is reasonable.

In conclusion, we concur with the recommendations of the report, and are taking actions on the recommendations.

If you have any questions on this response, please contact James A. Zammillo, Chief, Policy & Programs Coordination Staff, Office of Alcohol & Tobacco, at (202) 927-7953.



Bradley A. Buckles

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